

**DIRECT TESTIMONY**

**of**

**Dianna Hathhorn  
Accountant**

**Accounting Department  
Financial Analysis Division  
Illinois Commerce Commission**

**Request for Increase in Sewer Rates**

**Cedar Bluff Utilities, Inc.**

**Docket No. 03-0398**

**August 28, 2003**

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1 Q. Please state your name and business address.

2 A. My name is Dianna Hathhorn. My business address is 527 East Capitol  
3 Avenue, Springfield, Illinois 62701.

4

5 Q. By whom are you employed and in what capacity?

6 A. I am an Accountant in the Accounting Department of the Financial  
7 Analysis Division of the Illinois Commerce Commission ("Commission" or  
8 "ICC").

9

10 Q. What is the function of the Commission's Accounting Department?

11 A. The Department's function is to monitor the financial condition of public  
12 utilities as part of the Commission's responsibilities under Article IV of the  
13 Public Utilities Act and to provide accounting expertise on matters before  
14 the Commission.

15

16 Q. Please describe your background and professional affiliation.

17 A. I am a licensed Certified Public Accountant. I earned a B.S. in Accounting  
18 from Illinois State University in 1993. Prior to joining the Commission in  
19 1998, I worked as an internal auditor for another Illinois state agency for  
20 approximately 3.5 years. I also have 1.5 years experience in public  
21 accounting for a national firm.

22

23 Q. Have you previously testified before this Commission?

24 A. Yes, I have.

25

26 Q. What are your responsibilities in this case?

27 A. I have been assigned to this case by the Manager of the Commission's  
28 Accounting Department. I am to review Cedar Bluff Utilities Inc.'s  
29 ("Company") filing, analyze the underlying data and propose adjustments  
30 when appropriate.

31

32 Purpose of Testimony

33 Q. What is the purpose of your testimony in this proceeding?

34 A. The purpose of my testimony is to propose adjustments to the Company's  
35 operating statement and rate base concerning add-on taxes, insurance  
36 expense, income taxes, health insurance, rate case expense, monthly  
37 billing expense, and insurance claim expense.

38

39 Q. Are you sponsoring any schedules with your testimony?

40 A. Yes. I prepared the following schedules for the Company, which show  
41 data as of, or for the test year ending December 31, 2002:

42 Adjustment Schedules

43 Schedule 2.1 - Adjustment for Add-On Taxes

44 Schedule 2.2 - Adjustment to Non-Health Insurance Expense

45        Schedule 2.3 -        Adjustment to Income Taxes  
46        Schedule 2.4-        Adjustment to Health Insurance Expense  
47        Schedule 2.5-        Adjustment to Rate Case Expense  
48        Schedule 2.6 -        Adjustment to Monthly Billing Expense  
49        Schedule 2.7-        Adjustment to Amortize Insurance Claim Expense  
50

51        Adjustment for Add-On Taxes

52        Q.        Please describe Schedule 2.1, Adjustment for Add-On Taxes  
53        A.        Schedule 2.1 reflects my proposed adjustment to operating expense to  
54        disallow public utility taxes at present rates. Gross revenues taxes are an  
55        add-on charge to customers' bills, are not an actual operating expense of  
56        the utility, and therefore, should not be a part tariffed rates. According to  
57        the Company's response to Staff Data Request DLH-2.10, these amounts  
58        are not recorded in revenues; though, so no corresponding adjustment is  
59        needed to the revenues amounts in the revenue requirement. My  
60        adjustment is consistent with the Commission's practice to remove add-on  
61        taxes from both revenues and expenses.

62

63        Adjustment to Non-Health Insurance Expense

64        Q.        Please describe Schedule 2.2, Adjustment to Non-Health Insurance  
65        Expense.

66 A. Schedule 2.2 reflects my proposed adjustment to operating expense to  
67 disallow amounts from the Company's pro forma increase to insurance  
68 expense for amounts that are not known and measurable. The  
69 Company's requested increase is based on calculated amounts for auto,  
70 property, and worker's compensation premiums for 2004. My adjustment  
71 uses the 2003 rates for the 12-month period. The Company's estimate is  
72 based only on the percentage change in premiums from 2003 to 2004.  
73 The Company stated it would not receive its 2004 rates until  
74 approximately September 2003. (Company response to Staff Data  
75 Request DLH-3.01) If this timing is correct and the documentation is  
76 provided to me, I will revise my adjustment in rebuttal testimony to reflect  
77 the most recent known and measurable insurance rates. Until that time,  
78 the 2003 rates are proper to use.

79

80 Adjustment to Income Taxes

81 Q. Please describe Schedule 2.3, Adjustment to Income Taxes.

82 A. Schedule 2.3 presents my adjustment to state and federal income tax  
83 expense in the test year based on the use of a unitary state income tax  
84 rate. The Company pays its Illinois state income tax as a member of a  
85 unitary business group. Therefore, it is appropriate to use a unitary tax  
86 rate in determining the revenue requirement. This issue was previously  
87 litigated in Docket No. 98-0046, which was a rate case of an affiliate of the

88 Company that uses the same income tax expense methods. The  
89 Commission concluded in that docket that the unitary tax rate is proper for  
90 ratemaking purposes.  
91

92 Q. How was the unitary tax rate calculated?

93 A. The unitary tax rate that I use in my proposed adjustment is the average of  
94 the effective unitary tax rates for 1999 and 2000, which were calculated by  
95 dividing Utilities, Inc.'s Illinois state income tax liability for the respective  
96 year by its total state taxable income for that year.  
97

98 Q. Why was the effective unitary tax rate for 2002 or 2001 not used in the  
99 calculation of the unitary tax rate for the test year?

100 A. The Company has not yet filed its 2002 taxes. Also, the 2001 Illinois state  
101 income tax liability for Utilities, Inc. is zero; therefore, there is no Illinois  
102 state income tax rate for 2001. For ratemaking purposes, it is reasonable  
103 to calculate a unitary tax rate based on the two most recent years in which  
104 Utilities, Inc. incurred Illinois income tax liability.  
105

106 Adjustment to Health Insurance Expense

107 Q. Please describe Schedule 2.4, Adjustment to Health Insurance Expense.

108 A. Schedule 2.4 presents my adjustment to operating expense to reflect the  
109 most recent information available to calculate pro forma health insurance

110 expense over a 12-month period. The Company's adjustment is based  
111 upon the percentage change of the affected health and dental insurance  
112 accounts at 3/31/2003 compared to the same accounts at 3/31/2002,  
113 resulting in a 106.08% increase. My adjustment uses the 6/30/2003  
114 account balances to calculate an annualized 2003 expense. I then  
115 compare my calculated 12/31/2003 amount to the 12/31/2002 balance to  
116 determine the estimated percentage increase over the entire year, which  
117 is 27.34%. As my calculation is based upon more recent actual Company  
118 balances over a 12-month period, it is a better estimate of the increased  
119 cost of health and dental insurance.

120

121 Adjustment to Rate Case Expense

122 Q. Please describe Schedule 2.5, Adjustment to Rate Case Expense.

123 A. Schedule 2.5 reflects my proposed adjustment to operating expense to  
124 reduce the amount of Company hours on this case, and to change the  
125 amortization period from three to five years. The Company estimated one  
126 of its employees would spend 20 hours on this case, however timesheets  
127 provided by the Company show that this employee has only spent about  
128 two hours on this case through 6/30/2003. (Company response to Staff  
129 Data Request DLH-8.02) My adjustment is based upon an estimate that  
130 this employee will spend about as much time in the last phase of this case  
131 as the beginning, which calculates to 5 hours total for this employee.

132 Finally, the Company is seeking to recover the cost of the rate case over  
133 three years. I propose that these costs be recovered over 5 years. The  
134 Company's current rate structure was approved by the Commission on  
135 February 28, 1986. Given the amount of time that has elapsed since then,  
136 I believe that five years is a more appropriate and reasonable amortization  
137 period.

138  
139 Adjustment to Monthly Billing Expense

140 Q. Please describe Schedule 2.6, Adjustment to Monthly Billing Expense.

141 A. Schedule 2.6 reflects my proposed adjustment to operating expense to  
142 reflect updated costs for the Company's change to monthly billing. The  
143 cost information provided in discovery, in data request response DLH-  
144 3.06, differed from the amounts filed by the Company in its direct case.  
145 Therefore, my adjustment is necessary to reflect the proper amounts for  
146 the Company's pro forma adjustment for changing to monthly billing. It is  
147 my understanding that the Company agrees with this adjustment.

148  
149 Adjustment to Amortize Insurance Claim Expense

150 Q. Please describe Schedule 2.7, Adjustment to Amortize Insurance Claim  
151 Expense.

152 A. Schedule 2.7 reflects my proposed adjustment to operating expense to  
153 amortize the amount of an insurance claim paid in the test year. The

claim was the result of a sewer back-up that caused damage to the property of three people. (Company response to Staff Data Request DLH-5.03) The Company had no other insurance claims in the period 1998 through 2001. (Company response to Staff Data Request DLH-7.02) Therefore, it is not an on-going expense of the Company, and could be eliminated in its entirety. The claim amount of \$5,597, though, is rather significant when compared to the usual insurance claim expense allocated to the Company by Water Service Corp. ("WSC"), as shown below: (from Company trial balances)

Year	WSC Insurance Allocation (SE 52)
1999	\$559
2000	\$1,064
2001	\$532
2002	\$607

Therefore, in order to allow the Company the opportunity to recover a fair amount of this expense, but not overcompensate it due to the irregular nature of the claims, it is appropriate to amortize the insurance claim expense. I recommend a five-year amortization period, which I believe is reasonable.

Q. Does this conclude your prepared direct testimony?

A. Yes, it does.

Docket No. 03-0398  
ICC Staff Exhibit 2.0  
Schedule 2.1

Cedar Bluff Utilities, Inc.  
Adjustment for Add-On Taxes  
For the Test Year Ending December 31, 2002

Line No.	Description (a)	Amount (b)	Source (c)
1	Public Utility Taxes at present rates per Staff	\$ -	
2	Public Utility Taxes at present rates per Company	<u>46</u>	Company Workpaper f
3	Staff Proposed Adjustment	<u>\$ (46)</u>	

Cedar Bluff Utilities, Inc.  
 Adjustment to Non-Health Insurance Expense  
 For the Test Year Ending December 31, 2002

Line No.	Description	Amount	Source
	(a)	(b)	(c)
1	2002 Insurance Expense for WSC	\$ 1,167,898	Company workpaper b
2	Estimated Auto Increase	71,055	Schedule 2.2, p. 2, line 6
3	Estimated Workers Comp. Increase	42,372	Schedule 2.2, p. 2, line 12
4	Estimated Property Increase	23,193	Schedule 2.2, p. 2, line 18
5	Total Pro Forma Insurance Expense for WSC	\$ 1,304,518	Sum of lines 1 through 4
6	Cedar Bluff Allocation factor	0.0520%	Company workpaper b
7	Cedar Bluff pro forma insurance expense	\$ 678	Line 5 x line 6
8	Amount per Company	831	Company workpaper b
9	Staff Proposed Adjustment	\$ (153)	Line 7 - line 8

Cedar Bluff Utilities, Inc.  
 Adjustment to Non-Health Insurance Expense  
 For the Test Year Ending December 31, 2002

Line No.	Description	Amount	Source
	(a)	(b)	(c)
1	<u>Calculation of Estimated Auto Increase:</u>		
2	2003 Monthly Rate	\$ 23,346	Per Company prepared schedule
3	x 12 months	12	
4	2003 Auto Insurance Cost	\$ 280,152	Line 2 x line 3
5	2002 Auto Insurance Cost	209,097	Per Company prepared schedule
6	Difference	<u>\$ 71,055</u>	Line 4 - line 5
7	<u>Calculation of Estimated Workers Comp. Increase:</u>		
8	2003 Monthly Rate	\$ 23,233	Per Company prepared schedule
9	x 12 months	12	
10	2003 Workers Comp. Cost	\$ 278,796	Line 8 x line 9
11	2002 Workers Comp. Cost	236,424	Per Company prepared schedule
12	Difference	<u>\$ 42,372</u>	Line 10 - line 11
13	<u>Calculation of Estimated Property Ins. Increase:</u>		
14	2003 Monthly Rate	\$ 10,115	Per Company prepared schedule
15	x 12 months	12	
16	2003 Property Ins. Cost	\$ 121,380	Line 14 x line 15
17	2002 Property Ins. Cost	98,187	Per Company prepared schedule
18	Difference	<u>\$ 23,193</u>	Line 16 - line 17

Cedar Bluff Utilities, Inc.  
 Adjustment to Income Taxes  
 For the Test Year Ending December 31, 2002

Line No. (a)	Description (b)	Amount (c)
1	Total Operating Revenue	\$ 46,104
2	Total Operating Expense	(47,053)
3	Synchronized Interest	(3,232)
4	Net Income Before Taxes	<u>\$ (4,181)</u>
5	Unitary Rate	<u>1.8763%</u>
6	State Income Tax at Unitary Rate (Line 4 x Line 5)	<u>\$ (78)</u>
7	Net Income Before Federal Income Tax	\$ (4,103)
8	Federal Income Tax Rate	<u>34.0000%</u>
9	Federal Income Tax (Line 7 x Line 8)	<u>\$ (1,395)</u>
10	State Income Tax Per Staff (Line 6)	\$ (78)
11	State Income Tax Per Company	(206)
12	Adjustment	<u>\$ 128</u>
13	Federal Income Tax Per Staff (Line 9)	\$ (1,395)
14	Federal Income Tax Per Company	(1,194)
15	Adjustment	<u>\$ (201)</u>

Source:

Lines 1&2	ICC Staff Exhibit 1.0, Schedule 1.1, Column B
Line 3	Company Schedule B
Line 5	Schedule 2.3, Page 2, Line 3
Line 8	Company Workpaper W/P (h)
Lines 11, 14	Company Schedule B, with deferred taxes reclassified per amounts in trial balance

Cedar Bluff Utilities, Inc.  
Adjustment to Income Taxes  
For the Test Year Ending December 31, 2002

Line No.	Description	Amount
(a)	(b)	(c)
1	Unitary Tax Rate for 1999	<u>1.5014%</u>
2	Unitary Tax Rate for 2000	<u>2.2512%</u>
3	Unitary Tax Rate for Test Year	<u>1.8763%</u>

Source:

Line 1 Schedule 2.3, Page 3, Line 25  
Line 2 Schedule 2.3, Page 4, Line 25  
Line 3 (Line 1 + Line 2)/2

Cedar Bluff Utilities, Inc.  
Adjustment to Income Taxes  
For the Test Year Ending December 31, 2002

Calculation of Unitary Tax Rate for the Year 1999

Line No.	Description	Federal Taxable Income	State Income Tax	State Taxable Income	Gains on Sale of Assets	Adj. State Taxable Income
(a)	(b)	(c)	(d)	(e)	(f)	(g)
1	Apple Canyon	\$ 22,327	\$ 2,466	\$ 24,793		\$ 24,793
2	Camelot	38,435	2,845	41,280		41,280
3	Cedar Bluff	3,694	217	3,911		3,911
4	Charmar	4,197	296	4,495		4,495
5	Cherry Hill	21,757	1,805	23,562		23,562
6	Clarendon	25,588	1,727	27,315		27,315
7	County Line	7,806	714	8,520		8,520
8	Del Mar	4,048	330	4,378		4,378
9	Ferson Creek	53,779	2,897	56,676		56,676
10	Galena Territory	131,694	9,083	140,777		140,777
11	Great Northern	3,702	65	3,767		3,767
12	Harbor Ridge	20,780	2,296	23,076		23,076
13	Killarney	1,741		1,741		1,741
14	Lake Holiday	92,793	6,223	99,016		99,016
15	Lake Marian	29,775	2,884	32,659		32,659
16	Lake Wildwood	63,310	4,533	67,843		67,843
17	Medina	49,390	5,202	54,592		54,592
18	Northern Hills	77		77		77
19	Valentine	11,124	1,369	12,493		12,493
20	Walk-Up Woods	11,634	1,174	12,808		12,808
21	Whispering Hills	96,818	6,230	103,048		103,048
22	Utilities, Inc.	3,010,016	70,746	3,080,762	(984,753)	2,096,009
23	Total	\$ 3,704,485	\$ 123,104	\$ 3,827,589	\$ (984,753)	\$ 2,842,836
24	Illinois Tax Liability					\$ 42,682
25	Unitary Rate					1.5014%

Source:

Lines 1-22  
Line 24  
Line 25

Provided by the Company  
Utilities, Inc. tax return  
Line 24/Line 23

Cedar Bluff Utilities, Inc.  
Adjustment to Income Taxes  
For the Test Year Ending December 31, 2002

Calculation of Unitary Tax Rate for the Year 2000

Line No.	Description	Federal Taxable Income (c)	State Income Tax (d)	State Taxable Income (e)	Gains on Sale of Assets (f)	Adj. State Taxable Income (g)
(a)	(b)	(c)	(d)	(e)	(f)	(g)
1	Apple Canyon	\$ 34,542	\$ 1,679	\$ 36,221		\$ 36,221
2	Camelot	7,327	418	7,745		7,745
3	Cedar Bluff	5,651	607	6,258		6,258
4	Chammar	2,275	149	2,424		2,424
5	Cherry Hill	17,511	1,246	18,757		18,757
6	Clarendon	27,828	1,920	29,748		29,748
7	County Line	7,251	503	7,754		7,754
8	Del Mar	3,906	283	4,189		4,189
9	Ferson Creek	43,434	3,103	46,537		46,537
10	Galena Territory	133,547	9,546	143,093		143,093
11	Great Northern	8,017	452	8,469		8,469
12	Harbor Ridge	19,386	2,246	21,632		21,632
13	Killamey	8,079	439	8,518		8,518
14	Lake Holiday	98,850	8,021	106,871		106,871
15	Lake Marian	19,940	1,411	21,351		21,351
16	Lake Wildwood	31,986		31,986		31,986
17	Medina	44,022	4,597	48,619		48,619
18	Northern Hills	(1,507)		(1,507)		(1,507)
19	Valentine	6,887	660	7,547		7,547
20	Walk-Up Woods	11,268	1,000	12,268		12,268
21	Whispering Hills	118,822	6,797	125,619		125,619
22	Utilities, Inc.	718,570	57,375	775,945	(35,357)	740,588
23	Total	<u>\$ 1,367,592</u>	<u>\$ 102,452</u>	<u>\$ 1,470,044</u>	<u>\$ (35,357)</u>	<u>\$ 1,434,687</u>
24	Illinois Tax Liability					\$ 32,297
25	Unitary Rate					2.2512%

Source:

Lines 1-22  
Line 24  
Line 25

Provided by the Company  
Utilities, Inc. tax return  
Line 24/Line 23

Cedar Bluff Utilities, Inc.  
Adjustment to Health Insurance Expense  
For the Test Year Ending December 31, 2002

Line No.	Description (a)	Amount (b)	Source (c)
1	Pro forma health insurance expense per Staff	\$ 963	Note 1
2	Pro forma health insurance expense per Company	1,564	Company workpaper e
3	Staff Proposed Adjustment	<u>\$ (601)</u>	Line 1 - line 2
<u>Note 1:</u>			
	2002 Cedar Bluff health insurance expense	\$ 756	Company workpaper e
	Pro forma increase per Staff	27.34%	Schedule 2.4, page 2, line 11
	Pro forma health insurance expense per Staff	<u>\$ 963</u>	

Cedar Bluff Utilities, Inc.  
 Adjustment to Health Insurance Expense  
 For the Test Year Ending December 31, 2002

Line No.	Description	Amount	Source
	(a)	(b)	(c)
	<u>Water Service Corp. Balance at 6/30/2003:</u>		
1	Health Insurance Premiums	\$ 225,088	Company response to DLH-8.01
2	Dental Premiums	10,830	Company response to DLH-8.01
3	Health Insurance Reimbursements	1,204,228	Company response to DLH-8.01
4	Health Costs and Other	20,432	Company response to DLH-8.01
5	Dental Insurance Reimbursements	68,283	Company response to DLH-8.01
6	Employees Insurance Deductions	<u>(237,728)</u>	Company response to DLH-8.01
7	Total	\$ 1,291,133	
8	Average 2003 monthly expense	\$ 215,189	Line 7 divided by 6
9	Annualized 2003 total expense	\$ 2,582,266	Line 8 * 12
10	2002 total expense	\$ 2,027,835	Provided by Company
11	Percentage change	<u>27.34%</u>	(Line 9 / line 10) - 1

Cedar Bluff Utilities, Inc.  
Adjustment to Rate Case Expense  
For the Test Year Ending December 31, 2002

Line No.	Description (a)	Amount (b)	Source (c)
1	Rate case expense per Staff	\$ 759	Note 1
2	Rate case expense per Company	<u>1,519</u>	Company workpaper d
3	Staff Proposed Adjustment	<u>\$ (760)</u>	Line 1 - line 2
	<u>Note 1: Water Service Personnel hours</u>		
	Capitalization rate-SML	\$ 51	Company workpaper d
	SML estimated hours per Staff	<u>5</u>	
	SML estimated cost per Staff	<u>\$ 255</u>	
	Remainder of rate cases expenses unchanged by Staff	\$ 3,538	Company workpaper d
	Total rate case expense per Staff	<u>\$ 3,793</u>	
	5-year amortization period	<u>\$ 759</u>	

Docket No. 03-0398  
ICC Staff Exhibit 2.0  
Schedule 2.6

Cedar Bluff Utilities, Inc.  
Adjustment to Monthly Billing Expense  
For the Test Year Ending December 31, 2002

Line No.	Description (a)	Amount (b)	Source (c)
1	Monthly Billing Expense adjustment per Staff	\$ 556	Company response to DLH-3.06
2	Monthly Billing Expense adjustment per Company	<u>627</u>	Company workpaper c
3	Staff Proposed Adjustment	<u>\$ (71)</u>	Line 1 - line 2

Docket No. 03-0398  
ICC Staff Exhibit 2.0  
Schedule 2.7

Cedar Bluff Utilities, Inc.  
Adjustment to Amortize Insurance Claim Expense  
For the Test Year Ending December 31, 2002

Line No.	Description (a)	Amount (b)	Source (c)
1	Insurance Claim Expense per Staff	\$ 1,119	Line 5
2	Insurance Claim Expense per Company	<u>5,597</u>	Company response to DLH-5.03
3	Staff Proposed Adjustment	<u>\$ (4,478)</u>	Line 1 - line 2
4	Total Amount of Insurance Claim	\$ 5,597	Line 2
5	Amortized over 5 years	<u>\$ 1,119</u>	Line 4 / 5